

**Arizona Humane Society**

Financial Statements

Together with Independent Auditor's Report

October 31, 2013



**ARIZONA HUMANE SOCIETY**

Improving the Lives of Animals Since 1957

# ARIZONA HUMANE SOCIETY

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To the Board of Directors  
Arizona Humane Society  
Phoenix, Arizona

We have audited the accompanying financial statements of Arizona Humane Society (an Arizona nonprofit organization) (the "Organization"), which comprise the statement of financial position as of October 31, 2013, and the related statements of activities and cash flows for the year then ended, and the related notes to the financial statements.

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor's Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Arizona Humane Society as of October 31, 2013, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

## **Report on Summarized Comparative Information**

We have previously audited the Arizona Humane Society's 2012 financial statements, and our report dated January 31, 2013, expressed an unmodified opinion on those audited financial statements. In our opinion, the summarized comparative information presented herein as of and for the year ended October 31, 2012, is consistent, in all material respects, with the audited financial statements from which it has been derived.

*Schmidt Westergard & Company, PLLC*

Mesa, Arizona  
February 13, 2014

**ARIZONA HUMANE SOCIETY**  
**STATEMENT OF FINANCIAL POSITION**  
October 31, 2013 (with comparative totals as of October 31, 2012)

	<u>2013</u>	<u>2012</u>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 15,168,779	\$ 14,619,147
Estate receivables	1,357,386	1,825,380
Receivables	18,188	13,034
Inventories	192,891	111,163
Prepaid expenses and other assets	193,323	239,629
Investments	591,625	1,452,303
Property and equipment, net	11,175,026	10,862,896
Deposits	31,333	19,358
Beneficial interest in remainder trusts	2,509,000	1,941,000
Beneficial interest in perpetual trusts	5,100,000	4,638,000
	<u>\$ 36,337,551</u>	<u>\$ 35,721,910</u>
<b>LIABILITIES AND NET ASSETS</b>		
Accounts payable	\$ 313,754	\$ 178,057
Accrued liabilities	648,915	795,498
Charitable gift annuities payable	280,302	283,481
Total liabilities	<u>1,242,971</u>	<u>1,257,036</u>
Net assets		
Unrestricted		
Invested in property and equipment	11,175,026	10,862,896
Board designated	591,625	1,452,303
Unrestricted and undesignated	14,142,616	13,439,584
Total unrestricted	25,909,267	25,754,783
Temporarily restricted	4,085,313	4,072,091
Permanently restricted	5,100,000	4,638,000
Total net assets	<u>\$ 35,094,580</u>	<u>\$ 34,464,874</u>
	<u>\$ 36,337,551</u>	<u>\$ 35,721,910</u>

**ARIZONA HUMANE SOCIETY**

STATEMENT OF ACTIVITIES

For the year ended October 31, 2013 (with comparative totals for the year ended October 31, 2012)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	
				2013	2012
<b>SUPPORT AND REVENUE</b>					
Contributions	\$ 6,795,984	\$ 1,272,232	\$ -	\$ 8,068,216	\$ 9,032,951
Tributes and memorials	184,972	-	-	184,972	222,384
Donated materials and services	2,186,675	-	-	2,186,675	2,198,097
Grants	194,330	-	-	194,330	101,564
Clinic operations	1,252,263	-	-	1,252,263	1,350,428
Adoption fees	854,202	-	-	854,202	762,288
Animals intake	627,049	-	-	627,049	674,570
Education	19,049	-	-	19,049	18,535
Investment income, net	254,253	-	-	254,253	291,352
Gain (loss) on sale of property and equipment	(41,054)	-	-	(41,054)	4,091
Changes in value of split-interest agreements	(56,090)	560,864	462,000	966,774	529,824
Other	35,540	-	-	35,540	100,747
	<u>12,307,173</u>	<u>1,833,096</u>	<u>462,000</u>	<u>14,602,269</u>	<u>15,286,831</u>
Total support and revenue before special events, thrift store sales, retail sales, and net assets released from restrictions					
Special events revenue	1,130,097	-	-	1,130,097	983,907
Less costs of direct donor benefits	(199,352)	-	-	(199,352)	(175,358)
Gross profit on special events	<u>930,745</u>	<u>-</u>	<u>-</u>	<u>930,745</u>	<u>808,549</u>
Thrift store sales	713,895	-	-	713,895	434,284
Less related costs	(536,287)	-	-	(536,287)	(275,987)
Gross profit on thrift store sales	<u>177,608</u>	<u>-</u>	<u>-</u>	<u>177,608</u>	<u>158,297</u>
Pet supply stores	301,392	-	-	301,392	275,775
Less related costs	(304,851)	-	-	(304,851)	(302,770)
Loss on pet supply stores	<u>(3,459)</u>	<u>-</u>	<u>-</u>	<u>(3,459)</u>	<u>(26,995)</u>
Total support and revenue	<u>13,412,067</u>	<u>1,833,096</u>	<u>462,000</u>	<u>15,707,163</u>	<u>16,226,682</u>

The accompanying notes are an integral part of this financial statement.

**ARIZONA HUMANE SOCIETY**

## STATEMENT OF ACTIVITIES (CONTINUED)

For the year ended October 31, 2013 (with comparative totals for the year ended October 31, 2012)

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	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	
				2013	2012
NET ASSETS RELEASED FROM RESTRICTIONS	<u>1,819,874</u>	<u>(1,819,874)</u>	<u>-</u>	<u>-</u>	<u>-</u>
TOTAL SUPPORT, REVENUE AND NET ASSETS RELEASED FROM RESTRICTIONS	<u>15,231,941</u>	<u>13,222</u>	<u>462,000</u>	<u>15,707,163</u>	<u>16,226,682</u>
EXPENSES					
Program services	12,824,609	-	-	12,824,609	12,103,180
Management and general	519,901	-	-	519,901	384,139
Fundraising and development	<u>1,732,947</u>	<u>-</u>	<u>-</u>	<u>1,732,947</u>	<u>1,425,217</u>
TOTAL EXPENSES	<u>15,077,457</u>	<u>-</u>	<u>-</u>	<u>15,077,457</u>	<u>13,912,536</u>
CHANGE IN NET ASSETS	154,484	13,222	462,000	629,706	2,314,146
NET ASSETS – Beginning of year	<u>25,754,783</u>	<u>4,072,091</u>	<u>4,638,000</u>	<u>34,464,874</u>	<u>32,150,728</u>
NET ASSETS – End of year	<u>\$ 25,909,267</u>	<u>\$ 4,085,313</u>	<u>\$ 5,100,000</u>	<u>\$ 35,094,580</u>	<u>\$ 34,464,874</u>

The accompanying notes are an integral part of this financial statement.

**ARIZONA HUMANE SOCIETY****STATEMENT OF CASH FLOWS**

For the year ended October 31, 2013 (with comparative totals for the year ended October 31, 2012)

	<u>2013</u>	<u>2012</u>
Cash flows from operating activities:		
Change in net assets	\$ 629,706	\$ 2,314,146
Adjustments to reconcile change in net assets to net cash provided by operations:		
Depreciation	736,119	730,480
(Gain) loss on sale of property and equipment	41,054	(4,091)
Non-cash contribution of investments	(7,504)	(370,421)
Realized and unrealized (gain) loss on investments, net	9,887	(1,968)
Non-cash contribution of beneficial interest in remainder trust	(93,000)	-
Changes in value of split-interest agreements	(966,774)	(529,824)
Changes in operating assets and liabilities:		
(Increase) decrease in		
Estate receivables	467,994	235,735
Receivables	(5,154)	26,106
Inventories	(81,728)	(38,220)
Prepaid expenses and other assets	46,306	(147,708)
Deposits	(11,975)	(4,000)
Beneficial interest in remainder trusts	85,864	87,114
Increase (decrease) in		
Accounts payable	25,382	(73,325)
Accrued liabilities	(146,583)	99,103
Charitable gift annuities payable	(59,269)	(70,726)
Net cash provided by operations	<u>670,325</u>	<u>2,252,401</u>
Cash flows from investing activities		
Proceeds from maturities and sale of investments	858,295	1,804,206
Proceeds from sale of property and equipment	9,000	4,091
Purchases of property and equipment	<u>(987,988)</u>	<u>(437,814)</u>
Net cash (used in) provided by investing activities	<u>(120,693)</u>	<u>1,370,483</u>
Net increase in cash and cash equivalents	549,632	3,622,884
Cash and cash equivalents at the beginning of year	<u>14,619,147</u>	<u>10,996,263</u>
Cash and cash equivalents at the end of year	<u>\$ 15,168,779</u>	<u>\$ 14,619,147</u>

The accompanying notes are an integral part of this financial statement.

## **ARIZONA HUMANE SOCIETY**

### **NOTES TO FINANCIAL STATEMENTS**

October 31, 2013 (with summarized comparative totals as of October 31, 2012)

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#### **1. Description of Organization**

Arizona Humane Society (the "Organization") was incorporated in the state of Arizona in June 1957 as a nonprofit corporation. The Organization provides programs and services including animal intake and sheltering; adoptions; animal rescues and cruelty investigations; temporary sheltering for the pets of domestic violence victims, and for the pets of individuals in crisis; veterinary care for injured and ill animals; low-cost spay/neuter and wellness clinics in addition to other veterinary services; and mobile spay/neuter and disaster response services throughout the state of Arizona.

#### **2. Summary of Significant Accounting Policies**

##### *Basis of Presentation*

The Organization reports information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets and permanently restricted net assets.

##### *Prior Year Summarized Information*

The financial statements include certain prior year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the Organization's financial statements for the year ended October 31, 2012, from which the summarized information was derived.

##### *Cash and Cash Equivalents*

Cash and cash equivalents consist of demand deposits, savings and money market accounts. The Organization considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents.

##### *Estate Receivables*

Estate receivables are recognized as contribution revenue in the period the Organization receives notification that the court has found the will of the donor's estate to be valid and all conditions have been substantially met. Estate receivables are stated at the fair value of the assets the Organization expects to receive under the provisions of the will. Management provides for probable uncollectible amounts through a charge to earnings and a credit to the allowance for uncollectible estate receivables based on its assessment of the current status of individual balances. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the allowance and a credit to estate receivables. At October 31, 2013 and 2012, estate receivables are considered by management to be fully collectible and, accordingly, an allowance for doubtful accounts has not been provided.

**ARIZONA HUMANE SOCIETY**

## NOTES TO FINANCIAL STATEMENTS

October 31, 2013 (with summarized comparative totals as of October 31, 2012)

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*Receivables*

Receivables are stated at the amount management expects to collect from outstanding balances. Management provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowance based on its assessment of the current status of individual accounts. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to receivables. Management considers all receivables to be fully collectible at October 31, 2013 and 2012, and, accordingly, an allowance for doubtful accounts has not been provided.

*Promises to Give*

Unconditional promises to give are recognized as revenue in the period the promise is received and as assets, decreases of liabilities, or expenses depending on the form of the benefits received. Conditional promises to give are recognized when the conditions on which they depend are substantially met. Unconditional promises to give that are to be collected within one year are recorded at net realizable value. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of their estimated future cash flows. The discounts on these amounts are computed using risk-free interest rates applicable to the years in which the promises are received, adjusted for market risk. Amortization of the discounts is included in contribution support.

Management provides for probable uncollectible amounts through a charge to earnings and a credit to the allowance for uncollectible promises to give based on its assessment of the current status of individual balances. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the allowance for uncollectible contribution receivable and a credit to contribution receivable.

*Inventories*

Inventories consist of various pet supply items held for sale at the Pet Emporium and Petique and are stated at the lower of cost or market using the first-in, first-out (FIFO) method. Inventory in the thrift store is recorded at estimated fair value, which is determined based on its future economic benefits.

*Investments and Investment Income*

The Organization reports its investments in equity securities that have readily determinable fair values, and all investments in debt securities, at fair value. The fair values of investments are based on quoted market prices.

Income earned from investments, including realized and unrealized gains and losses, is reported as increases or decreases in unrestricted net assets, unless a donor or law temporarily or permanently restricts their use.

**ARIZONA HUMANE SOCIETY**

**NOTES TO FINANCIAL STATEMENTS**

October 31, 2013 (with summarized comparative totals as of October 31, 2012)

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*Property and Equipment*

Depreciation of property and equipment is provided using the straight-line method over the following estimated useful lives:

Buildings	5 - 40 years
Leasehold improvements	1 - 5 years
Furniture and equipment	3 - 20 years
Vehicles	3 - 5 years

Donations of property and equipment are reported as increases in unrestricted net assets unless the donor has restricted the donated asset to a specific purpose. Assets donated with explicit restrictions regarding their use and contributions of cash that must be used to acquire property and equipment are reported as restricted contributions. Absent donor stipulations regarding how long those donated assets must be maintained, the Organization reports expirations of donor restrictions when the donated or acquired assets are placed in service as instructed by the donor, at which time the Organization reclassifies temporarily restricted net assets to unrestricted net assets.

*Impairment of Long-Lived Assets*

The Organization reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. Management does not believe impairment indicators are present.

*Split-Interest Agreements*

The Organization has received various types of split-interest agreements including remainder and perpetual trusts. Under remainder trust agreements, the Organization records a temporarily restricted contribution at the present value of the estimated future benefits to be received. Subsequent changes in fair value for the remainder trust are recorded as changes in value of split-interest agreements in the temporarily restricted net asset class.

Under perpetual trust agreements, the Organization records the permanently restricted contribution at the fair value of the Organization's beneficial interest in the trust assets. Income earned on the trust assets is recorded as unrestricted investment income in the accompanying statement of activities, unless otherwise restricted by the donor or law. Subsequent changes in fair value of the beneficial interest in the trust assets are recorded as changes in value of split-interest agreements in the permanently restricted net asset class.

**ARIZONA HUMANE SOCIETY**

## NOTES TO FINANCIAL STATEMENTS

October 31, 2013 (with summarized comparative totals as of October 31, 2012)

*Contributions*

Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support depending on the existence and/or nature of any donor restrictions. All donor-restricted support is reported as an increase in temporarily or permanently restricted net assets depending on the nature of the restriction. When a restriction expires (that is, when a stipulated time restriction ends or purpose restriction is accomplished), temporarily or permanently restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. However, if a restriction is fulfilled in the same period in which it is received, the Organization reports the support as unrestricted.

*Special Events Revenue*

The Organization conducts special events in which a portion of the gross proceeds paid by the participant represents payment for the direct cost of the benefits received by the participant at the event. Unless a verifiable, objective reason exists to demonstrate otherwise, the fair value of meals and entertainment provided at special events is measured at the actual cost to the Organization. The direct costs of the special events which ultimately benefit the donor rather than the Organization are included in special events revenues and simultaneously recorded as costs of direct donor benefits. All proceeds received in excess of the direct costs are recorded as gross profit on special events in the accompanying statement of activities.

*Donated Materials and Services*

The Organization recognizes donations of materials and services received at their estimated fair value if such services create or enhance nonfinancial assets or require specialized skills which are provided by individuals possessing those skills and would otherwise need to be purchased if not donated. Donated materials and services are recognized as contributions in the accompanying financial statements at their estimated fair value at the date of receipt.

Donated materials and services consisted of the following for the year ended October 31, 2013:

	Functional Category Benefitted:			Total
	Program Services	Management and General	Fundraising and Development	
Media services	\$ 1,752,173	\$ -	\$ 301,753	\$ 2,053,926
Legal services	-	5,000	-	5,000
Other	28,600	-	9,149	37,749
Total in-kind expense	<u>\$ 1,780,773</u>	<u>\$ 5,000</u>	<u>\$ 310,902</u>	2,096,675
Net increase in donated thrift store inventory				<u>90,000</u>
Total in-kind contributions				<u>\$ 2,186,675</u>

**ARIZONA HUMANE SOCIETY**

## NOTES TO FINANCIAL STATEMENTS

October 31, 2013 (with summarized comparative totals as of October 31, 2012)

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Donated materials and services consisted of the following for the year ended October 31, 2012:

	<u>Functional Category Benefitted:</u>			<u>Total</u>
	<u>Program Services</u>	<u>Management and General</u>	<u>Fundraising and Development</u>	
Media services	\$ 1,852,476	\$ -	\$ 276,500	\$ 2,128,976
Legal services	-	6,260	-	6,260
Other	<u>23,400</u>	<u>-</u>	<u>6,461</u>	<u>29,861</u>
Total in-kind	<u>\$ 1,875,876</u>	<u>\$ 6,260</u>	<u>\$ 282,961</u>	2,165,097
Net increase in donated thrift store inventory				<u>33,000</u>
Total in-kind contributions				<u>\$ 2,198,097</u>

No amounts have been reflected in the financial statements for certain donated volunteer services because they did not qualify for recording under current accounting requirements; however, a substantial number of volunteers have donated significant amounts of their time to the Organization's program services and its fundraising campaigns. The Organization received volunteer time and other donated services valued at approximately \$4,672,000 and \$4,234,000, representing 311,484 hours and 282,246 hours, for the years ended October 31, 2013 and 2012, respectively, that did not meet the recognition requirements. Accordingly, these amounts are not reflected in the accompanying financial statements.

*Thrift Store Revenues*

The Organization receives donations of supplies and food and sells these items to the general public through two thrift stores. The donated items are recorded in the statement of activities at their fair value which is based on the selling price of the specific items. Net thrift store revenues were approximately \$714,000 and \$434,000 for the years ended October 31, 2013 and 2012, respectively.

*Revenue Recognition*

The Organization charges a fee for the adoption of animals. Adoption fee revenue is recognized at the time an animal is adopted. The Organization charges a fee for hospital operations and spay/neutering services. Hospital and public clinic operations revenue is recognized at the time services are performed.

*Functional Expense Allocation*

The costs of providing various programs and other activities have been summarized on a functional basis in the accompanying statement of activities. Accordingly, certain costs have been allocated among the programs and supporting activities benefited, determined by specific identification and estimates of time spent and benefits derived.

**ARIZONA HUMANE SOCIETY**

## NOTES TO FINANCIAL STATEMENTS

October 31, 2013 (with summarized comparative totals as of October 31, 2012)

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*Advertising*

The Organization uses advertising to promote its programs to the various groups it serves. Advertising costs are charged to operations as incurred. Advertising expense totaled approximately \$210,000 and \$169,000, not including donated services described above, for the years ended October 31, 2013 and 2012, respectively.

*Income Tax Status*

The Organization is exempt from federal and state income taxes under Section 501(c)(3) of the Internal Revenue Code (the "IRC") and similar state provisions. However, income from certain activities not directly related to the Organization's tax-exempt purpose may be subject to taxation as unrelated business income. In addition, the Organization qualifies for the charitable contribution deduction under Section 170(b)(1)(A) of the IRC and has been classified as an organization other than a private foundation under Section 509(a)(1) of the IRC. The Organization has provided for income taxes on its unrelated business income, which have not been significant, as required by Section 512 of the Code.

The Organization follows the guidance issued by the Financial Accounting Standards Board ("FASB") related to accounting for income tax uncertainties. Under this guidance, the Organization accounts for the effect of any uncertain tax positions based on whether it is "more-likely-than-not" that the position will be sustained by the taxing authority upon examination. The Organization routinely evaluates potential uncertain tax positions. The Organization has identified its status as an exempt organization as a tax position; however, the Organization has determined that such tax position does not result in an uncertainty that requires recognition.

The Organization files informational and income tax returns in the U.S. federal jurisdiction and in certain state and local jurisdictions. As of October 31, 2013, U.S. federal informational and income tax returns for years ended prior to October 31, 2010 and state returns for years ended prior to October 31, 2009 are closed to assessment. Interest and penalties, if any, are accrued as a component of management and general expenses when assessed.

*Reclassifications*

Certain reclassifications have been made to the prior year summarized comparative information in order to conform to the current year presentation. The reclassification had no effect on the change in net assets.

**3. Estimates**

The presentation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

**ARIZONA HUMANE SOCIETY**

## NOTES TO FINANCIAL STATEMENTS

October 31, 2013 (with summarized comparative totals as of October 31, 2012)

**4. Estate Receivables**

Estate receivables consisted of the following, all of which are due in less than one year and are stated at the amount management expects to collect, at October 31:

	<u>2013</u>	<u>2012</u>
Blumstein estate	\$ 306,717	\$ 306,717
Pollpeter estate	216,897	-
Faber estate	172,233	-
Caldwell estate	121,118	-
Wiseman estate	60,039	-
Sacks estate	51,401	-
Dodson estate	50,098	45,000
Subit estate	50,000	168,000
Uphoff estate	49,032	-
Bendure estate	32,687	-
O'Brien estate	32,092	-
Applegate estate	-	108,391
Benson estate	-	475,000
Fisher estate	-	250,000
Joyce estate	-	49,000
Knudsen estate	-	50,000
Leader estate	-	52,472
Long estate	-	183,335
O'Bryant estate	-	87,000
Other	215,072	50,465
Total estate receivables	<u>\$ 1,357,386</u>	<u>\$ 1,825,380</u>

**5. Investments**

The Organization did not incur any investment expense for the years ended October 31, 2013 and 2012. Investment income consisted of the following for the years ended October 31:

	<u>2013</u>	<u>2012</u>
Interest income	\$ 264,140	\$ 289,384
Net realized and unrealized gains/(losses)	<u>(9,887)</u>	<u>1,968</u>
Total investment income, net	<u>\$ 254,253</u>	<u>\$ 291,352</u>

**ARIZONA HUMANE SOCIETY**

## NOTES TO FINANCIAL STATEMENTS

October 31, 2013 (with summarized comparative totals as of October 31, 2012)

**6. Property and Equipment**

Property and equipment consisted of the following at October 31:

	<u>2013</u>	<u>2012</u>
Buildings	\$ 13,429,293	\$ 13,337,916
Furniture and equipment	2,291,634	2,039,316
Land	2,139,948	1,985,522
Vehicles	1,191,083	1,015,393
Assets not placed in service	272,521	75,052
Leasehold improvements	<u>88,859</u>	<u>50,929</u>
Total property and equipment	19,413,338	18,504,128
Less - Accumulated depreciation	<u>(8,238,312)</u>	<u>(7,641,232)</u>
Property and equipment, net	<u>\$ 11,175,026</u>	<u>\$ 10,862,896</u>

Depreciation expense totaled approximately \$736,000 and \$730,000 for the years ended October 31, 2013 and 2012, respectively.

**7. Split-Interest Agreements***Remainder Trusts*

The Organization is the beneficiary of certain remainder trusts that are controlled by third party trustees. The Organization is entitled to 11% through 100% of the annual income distributions of the trusts. At the various expiration dates, the trusts will distribute any remaining assets held in the trust, at which time the Organization will be entitled to 11% through 100% of those final distribution amounts, with no restrictions. The Organization estimated the fair value of its beneficial interests in the remainder trusts at October 31, 2013 and 2012 based upon the fair value of the assets held by the trusts and the expected term of the trust, using a discount rate of 5%.

*Perpetual Trusts*

The Organization is also the income beneficiary of certain perpetual trusts. The trusts are held and controlled by third party trustees. The Organization is entitled to a specified percentage, as defined in each trust agreement, of the annual income distributions from each of the trusts. The Organization will also be entitled to a specified percentage of the total amount of the corpus assets that will be distributed if the trusts are ever dissolved. The Organization estimated the fair value of its beneficial interest in perpetual trusts at October 31, 2013 and 2012 based upon the Organization's respective interest in the fair value of the underlying assets held by the trust. Income distributions from perpetual trusts totaled approximately \$208,000 for each of the years ended October 31, 2013 and 2012, respectively, and are included in investment income in the accompanying statement of activities.

## ARIZONA HUMANE SOCIETY

### NOTES TO FINANCIAL STATEMENTS

October 31, 2013 (with summarized comparative totals as of October 31, 2012)

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#### 8. Charitable Gift Annuities

Charitable gift annuities are arrangements between a donor and the Organization in which the donor contributes assets to the Organization in exchange for a promise from the Organization to pay the donor a fixed amount for a specified period of time. These agreements provide for quarterly payments of approximately \$21,000 to the donors over the term of the agreements (the donors' expected lifetimes).

Assets received have been recognized at fair value, and an annuity payment liability was recorded at the present value of the estimated annuity awards payable to the beneficiaries over the expected term of the agreement using a discount rate of 8%. Unrestricted contribution revenue is recognized as the difference between these two amounts as the donor has placed no restriction on the Organization's use of its portion of the assets. Assets of the Organization that are derived from charitable gift annuities are included in investments in the accompanying statement of financial position. Charitable gift annuity amounts payable are estimated through December 2045.

The charitable gift annuities balance is reduced by payments to the beneficiaries. Adjustments to the value of the charitable gift annuities related to changes in present value or actuarial assumptions during the term of the charitable gift annuities agreement are recognized as changes in the value of split-interest agreements in the accompanying statement of activities. The change in the value of the charitable gift annuities for the years ended October 31, 2013 and 2012 was a decrease of approximately \$56,000 and \$33,000, respectively.

#### 9. Fair Value Measurements

The Organization follows the authoritative guidance for accounting for certain assets and liabilities that are required to be measured at fair value. This guidance outlines a valuation framework that provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value.

Fair value measurements are determined based on the assumptions (referred to as "inputs") that market participants would use in pricing the asset. Observable inputs are inputs that market participants would use in pricing the asset or liability based on market data obtained from independent sources. Unobservable inputs reflect the Organization's own assumptions about the assumptions that market participants would use in pricing the asset or liability based on the best information available in the circumstances. The fair value hierarchy includes three levels that are based on the extent to which inputs used in measuring fair value are observable in the market:

- Level 1* Inputs for the fair value measurement are quoted prices in an active market for identical assets or liabilities. Quoted prices in an active market for identical assets or liabilities provide the most reliable evidence of fair value.
- Level 2* Inputs for the fair value measurement are other than quoted prices in active markets, which are either directly or indirectly observable as of the report date.
- Level 3* Inputs for the fair value measurement are unobservable and are used to measure fair value only when observable inputs are not available.

The fair value hierarchy requires the use of observable market data when available. In instances where inputs used to measure fair value fall into different levels of the fair value hierarchy, the fair value measurement is determined based upon the lowest level input that is significant to the fair value measurement in its entirety. The following tables set forth, by level within the fair value hierarchy, the Organization's assets that are measured at fair value on a recurring basis as of October 31:

**ARIZONA HUMANE SOCIETY****NOTES TO FINANCIAL STATEMENTS**

October 31, 2013 (with summarized comparative totals as of October 31, 2012)

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	2013			
	Level 1	Level 2	Level 3	Total
Assets				
Investments				
Certificates of Deposits	\$ -	\$ 97,978	\$ -	\$ 97,978
Savings Bonds	180,012	-	-	180,012
Common Stock	113,359	-	-	113,359
Government Bonds	50,591	-	-	50,591
Mutual Funds - Equities	149,685	-	-	149,685
Total Investments	493,647	97,978	-	591,625
Split-Interest Agreements	-	-	7,609,000	7,609,000
Total Assets	<u>\$ 493,647</u>	<u>\$ 97,978</u>	<u>\$ 7,609,000</u>	<u>\$ 8,200,625</u>
	2012			
	Level 1	Level 2	Level 3	Total
Assets				
Investments				
Certificates of Deposits	\$ -	\$ 673,643	\$ -	\$ 673,643
Savings Bonds	173,022	-	-	173,022
Common Stock	106,475	-	-	106,475
Government Bonds	56,219	-	-	56,219
Mutual Funds - Equities	151,878	-	-	151,878
Mutual Funds - Bonds	291,066	-	-	291,066
Total Investments	778,660	673,643	-	1,452,303
Split-Interest Agreements	-	-	6,579,000	6,579,000
Total Assets	<u>\$ 778,660</u>	<u>\$ 673,643</u>	<u>\$ 6,579,000</u>	<u>\$ 8,031,303</u>

**ARIZONA HUMANE SOCIETY**

## NOTES TO FINANCIAL STATEMENTS

October 31, 2013 (with summarized comparative totals as of October 31, 2012)

The following is a reconciliation of the beginning and ending balances of assets measured at fair value on a recurring basis using Level 3 inputs during the years ended October 31, 2013 and 2012:

	<u>Split-Interest Agreements</u>
Level 3 ending balance 2011	\$ 6,103,000
Distributions from trusts	(87,114)
Changes in value	<u>563,114</u>
Level 3 ending balance 2012	\$ 6,579,000
Additions (contributions)	93,000
Distributions from trusts	(85,864)
Changes in value	<u>1,022,864</u>
Level 3 ending balance 2013	<u><u>\$ 7,609,000</u></u>

During the years ended October 31, 2013 and 2012, the Organization received charitable gift annuities payable. The Organization estimates the fair value of the liabilities associated with these charitable gift annuities on a non-recurring basis at the date of gift using the methods described in Note 8. The following sets forth, by level within the fair value hierarchy, the fair value of the charitable gift annuity liabilities recognized on the date of gift during the years ended October 31:

	<u>2013</u>			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Liabilities				
Charitable gift annuities payable	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 24,346</u>	<u>\$ 24,346</u>
Total Liabilities	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 24,346</u></u>	<u><u>\$ 24,346</u></u>
	<u>2012</u>			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Liabilities				
Charitable gift annuities payable	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 17,805</u>	<u>\$ 17,805</u>
Total Liabilities	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 17,805</u></u>	<u><u>\$ 17,805</u></u>

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Organization believes that its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine fair value could result in a different fair value measurement at the reporting date.

**ARIZONA HUMANE SOCIETY****NOTES TO FINANCIAL STATEMENTS**

October 31, 2013 (with summarized comparative totals as of October 31, 2012)

**10. 401 (K) Plan**

The Organization has a 401(k) Plan that covers all employees who meet specified age and time of service requirements. The Plan provides for participating employees to defer up to 100% of their compensation, not to exceed \$17,000 (as adjusted for inflation). The Organization's contributions to the Plan for the years ended October 31, 2013 and 2012 were approximately \$23,000 and \$27,000, respectively.

**11. Board Designated Net Assets**

The Organization has set aside approximately \$592,000 as Board designated net assets to be used in the future as determined by the Board. The earnings from the Board designated net assets are currently being reinvested, but may be used for operating expenses of the Organization in the future.

**12. Temporarily Restricted Net Assets**

Temporarily restricted net assets consisted of the following at October 31:

	<u>2013</u>	<u>2012</u>
Time restrictions:		
Estate receivables	\$ 1,357,386	\$ 1,825,380
Beneficial interest in remainder trusts	2,509,000	1,941,000
Other	-	10,000
Purpose restrictions:		
Spay/neuter programs	147,092	191,258
Facility improvements	-	36,654
Other	71,835	67,799
Total temporarily restricted net assets	<u>\$ 4,085,313</u>	<u>\$ 4,072,091</u>

**ARIZONA HUMANE SOCIETY**

## NOTES TO FINANCIAL STATEMENTS

October 31, 2013 (with summarized comparative totals as of October 31, 2012)

**13. Commitments**

The Organization leases equipment and store space under operating lease agreements with terms expiring through 2017. Future minimum rental payments under the non-cancellable operating leases are as follows:

Year Ending October 31	
2014	\$ 211,525
2015	185,328
2016	149,918
2017	<u>35,388</u>
Total future minimum lease payments	<u>\$ 582,159</u>

Rent expense totaled approximately \$196,000 and \$172,000 for the years ended October 31, 2013 and 2012, respectively.

**14. Cash Flow Information**

During the year ended October 31, 2013, the Organization purchased approximately \$110,000 of property and equipment through accounts payable.

**15. Concentrations of Credit Risk**

Financial instruments that potentially subject the Organization to concentrations of credit risk consist principally of cash deposits in financial institutions and investments.

Cash deposits in excess of amounts insured by the Federal Deposit Insurance Corporation ("FDIC") of \$250,000 and the Securities Investors Protection Corporation ("SPIC") of \$100,000 are exposed to loss in the event of nonperformance by the financial institution. At times during the year, the Organization had cash deposits in excess of the FDIC insurance coverage. The Organization does not anticipate nonperformance by financial institutions. At October 31, 2013, the Organization had an uninsured cash balance of approximately \$13,871,000.

Investments are exposed to various risks, such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in risks in the near term would materially affect account balances and the amounts reported in the accompanying financial statements.

**16. Subsequent Events**

Management evaluated subsequent events through February 13, 2014, the date the financial statements were available.